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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 664

NATIONAL FRUIT PRODUCT COMPANY, INCORPORATED,
Petitioner

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals (R. 30-31) is reported at 199 F. 2d 754. The opinion of the District Court (R. 19-27) is reported at 105 F. Supp. 658.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1952. (R. 32.) A petition

for rehearing (R. 33-39), timely filed by National Fruit Product Company on December 9, 1952, was denied without opinion on December 18, 1952 (R. 40). The petition for a writ of certiorari was filed on March 17, 1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals erred in holding that, in computing the taxpayer's net operating loss deduction for the fiscal year 1946 for excess profits tax purposes, the net operating loss for the fiscal year 1948 and the resulting net operating loss carry-back to the fiscal year 1946 should be reduced by 50% of the interest paid or accrued in the fiscal year 1948 on borrowed capital, under the provisions of Section 711(a)(2)(L) of the Internal Revenue Code.

STATUTES INVOLVED

These will be found in the Appendix, *infra*, pp. 10-17.

STATEMENT

A stipulation of facts (R. 15-19) was filed, with no additional evidence being offered. The facts may be summarized as follows:

Petitioner is the successor in interest to the taxpayer, a Virginia corporation which kept its books on an accrual basis with its fiscal year ending on June 30th. (R. 15-16.)

Taxpayer filed its income and excess profits tax returns for the fiscal year 1946, and computed its excess profits credit for that year pursuant to the provisions of Section 714 of the Internal Revenue Code, providing for an excess profits credit based on invested capital. The resulting tax liability was duly paid. (R. 16-17, 18-19.)

Taxpayer's income tax return for the fiscal year 1948 showed a net loss of $209,331.46, based partly on an interest deduction of $142,643.17. Of this latter amount, $106,564.66 represented interest on outstanding indebtedness of taxpayer within the definition of borrowed capital set forth in Section 719(a)(1) of the Internal Revenue Code. (R. 17.) Taxpayer duly filed a claim for a refund of taxes paid for the year 1946, based on a carry-back of the net loss sustained in 1948. (R. 17-18.)

A portion of this claim was adjusted and allowed and is not now in controversy. However, the Commissioner of Internal Revenue, in his final determination of excess profits tax liability for 1946, reduced the net operating loss for 1948 and the resulting net operating loss carry-back to 1946 by the amount of $53,282.33, representing 50% of the interest on outstanding indebtedness within the definition of borrowed invested capital contained in Section 719(a)(1) of the Internal Revenue Code. (R. 18.) The District Court upheld this reduction of the net operating loss deduction for 1946. (R. 19-27.) The Court of Appeals affirmed in a *per*

curiam opinion (R. 30-31) and denied a rehearing without an opinion (R. 40).

ARGUMENT

This case presents no question calling for review by this Court. As the taxpayer specifically recognizes (Pet. 10), no conflict of decisions is involved; nor do we believe that the Commissioner has taken conflicting positions.[1] And the question in the case has only a limited importance, since the excess profits tax provisions of the Code, Section 711 (a)(2)(L)(i) (Appendix, *infra*, p. 14) of which is involved here, were repealed effective with taxable years beginning after December 31, 1945, by Section 122 of the Revenue Act of 1945 (Appendix, *infra*, pp. 16-17), except that they remained in

[1] The taxpayer cautiously mentions two cases, which he says "appear to conflict in principle." (Pet. 10) These are so clearly distinguishable as to warrant a minimum of discussion here. In *Aluminum Products Co.* v. *United States*, 101 F. Supp. 373 (C. Cls.), the taxpayer in 1946 was a personal holding company under Section 501 and its income was personal holding company income under Section 502; therefore, by Section 727 (e) of the Code, it was not subject to the provisions of the excess profits tax law, even though it had been subject to the tax in 1944, the year to which the carry-back was claimed. In *Olympic Radio & Television* v. *United States*, 108 F. Supp. 109 (C. Cls.), rehearing denied March 3, 1953, with opinion (1953 C.C.H., par. 9233), the issue involved the deduction and carry-back of excess profits taxes on 1945 profits, which were not paid until 1946, the year of the net operating loss. Cf. *Lewyt Corp.* v. *Commissioner*, 18 T.C. 1245. Neither case has any bearing on the instant case, nor was the Commissioner's position in those cases inconsistent with his position here.

force for purposes of determining carry-backs from years after 1945, such carry-backs being allowable from the two subsequent years only.[2] Moreover, the decision below is clearly correct.

The provisions of the excess profits tax law (subchapter E of Chapter 2 of the Code) were applicable to the fiscal year 1946 involved here. By virtue of Section 122 (a) and (b) of the Revenue Act of 1945 (Appendix, *infra*, p. 16), the provisions imposing the excess profits tax were not in effect in 1948, except that they remained in full force and effect for the purpose of determining carry-backs in computing the excess profits tax for certain earlier years, including the fiscal year ended June 30, 1946, "as if the excess profits tax had not been repealed" (R. 24). Thus, as both lower courts correctly held (R. 19-27, 30-31), Section 711 (a)(2)(L) of the Internal Revenue Code, dealing with carry-backs, requires by its very terms that the amount of the taxpayer's net operating loss deduction for its fiscal year 1946 under Code Sections 23 (s) and 122, resulting from the carry-back of its net operating loss for the fiscal year 1948, be reduced by $53,282.33, representing one-half of the

[2] Taxpayer's assertion that this case will determine questions arising under the present excess profits tax statutes (Pet. 9) is not believed to be correct. The question here arises only because of the 1945 repealing provisions which continued the former excess profits law in effect to determine carry-backs from two later years, and the current law has not yet been repealed with the particular proviso involved here, nor is it presently predictable that it will be.

interest paid or accrued in 1948 on outstanding indebtedness constituting borrowed capital of the taxpayer. Cf. *Reo Motors* v. *Commissioner,* 338 U.S. 442, 446-447, 450.

That such is the intent and effect of Section 122 (b) of the Revenue Act of 1945 is perfectly clear from the statutory language itself (*infra,* p. 16), and H. Conference Rep. No. 1165, 79th Cong., 1st Sess., p. 7 (1945 Cum. Bull. 654, 655), confirms this fully when it states:

> * * * despite the repeal of the excess-profits tax for 1946, the provisions of the excess-profits-tax law shall remain in force * * * so as to assure the making of the necessary adjustments in the net operating loss carry-backs.

The taxpayer's contrary argument (Pet. 4-9) was correctly and summarily rejected by the Court of Appeals (R. 30-31). Its contention appears to be that even if Section 711 (a) (2) (L) of the excess profits law remained in effect after 1946 for carry-back purposes, still that section would not require reduction of the operating loss by 50 percent of the interest on outstanding indebtedness constituting borrowed capital in computing the deduction for 1946 arising out of the carry-back from 1948, because taxpayer did not actually compute an excess profits credit for the year 1948 at all, and thus had no occasion to compute an excess profits credit for 1948 under the special formula set forth in Sec-

tions 711(a)(2)(L)(i) and 714. It is true that the taxpayer was not subject to an excess profits tax in 1948, because the tax had been terminated by Congress, and thus the taxpayer did not compute an excess profits credit in 1948 under Section 714, or compute its borrowed capital under Section 719 for the purpose of determining any excess profits tax liability in that year. But it does not follow that Section 711 (a)(2)(L)(i) does not apply to it so far as the carry-back to 1946 is concerned. Subparagraph (L) was added in 1942 and when enacted was, of course, phrased with the thought that there would be excess profits tax liability for both of the years with which it dealt, rather than that there would be no liability for the tax in the later year. In providing in Section 122 (b) of the 1945 Act, the repealing statute, that the section should remain in effect to assure making the necessary adjustments in the net operating loss carry-back, Congress obviously did not intend or contemplate that an excess profits credit and borrowed capital would actually be computed as a step in determining excess profits tax liability for 1948, since the tax was being repealed for that year. Rather, Section 711 (a)(2)(L) was continued in effect under the assumption and intention that the excess profits credit and borrowed capital would be determined for the purpose of computing a carry-back to earlier years, just as if the tax had not been repealed. Any other construction would rob Section 122 (b) of the 1945 Act

of any effect or application insofar as Section 711 (a)(2)(L) is concerned.

It remains only to point out that the record contains nothing to show that the theoretical excess profits credit in 1948 was not properly computed under Section 714, *i.e.*, under the invested capital method, or that the Commissioner did not so determine in denying the claim for refund to the extent in issue here. On the contrary, in the absence of a showing by the taxpayer that use of the average earnings method for the fiscal year 1948 would have given it a larger excess profits credit for that year, it must be assumed that, since the taxpayer computed its excess profits credit for the fiscal year 1946 under the invested capital method (R. 18-19), it would continue to compute it for 1948 under the same method. In the absence of proof, it must be taken that the average earnings of the base period as prescribed by Section 713 of the Code (26 U.S.C. 1946 ed., Sec. 713) were too low to be taken as a measure of normal profits. This assumption is reinforced by the fact that the year 1947 was a year of generally good business activity and profits, and under Section 718 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 718), additional earnings and profits not distributed would add to the invested capital base on which the excess profits credit would be computed. We have no facts in the record to indicate that the taxpayer had a loss in the fiscal year 1947. Since the taxpayer has not sustained its burden of proving the contrary, the

record supports only the inference that the Commissioner properly computed the excess profits credit in 1948 on the invested capital method, as a step in determining the allowable loss carry-back to 1946.

CONCLUSION

The decision below is correct. There is no conflict in the decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [as added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 122 [as added by Sec. 211 (b) of the Revenue Act of 1939, *supra,* and amended by Secs. 105 (e) and 153 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss,

such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * * *

(c) *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)), exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e)).

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

SEC. 710 [as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. IMPOSITION OF TAX.

* * * * *

(c) [as added by Sec. 2 (b), Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and amended by Sec. 204 (b), Revenue Act of 1942, *supra*] *Unused Excess Profits Credit Adjustment.*—

* * * * *

(2) *Definition of unused excess profits credit.*—The term "unused excess profits credit" means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, computed on the basis of the excess profits credit applicable to such taxable year. For such purpose the excess profits credit and the excess profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941. The unused excess profits credit for a taxable year of less than twelve months shall be an amount which is such part of the unused excess profits credit determined under the first sentence of this paragraph as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

* * * * *

(26 U. S. C., 1946 ed., Sec. 710.)

SEC. 711 [as added by Sec. 201, Second Revenue Act of 1940, *supra*]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for

any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made;

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(J) [as added by Sec. 210 (a), Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations specified in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (B), without regard to any credit for dividends received, and without regard to any

credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(B) *Interest.*—The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a));

* * * * *

(L) [as added by Sec. 210 (b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations provided in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (D), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26(a) exceeds the excess profits net income (computed without the net operating loss deduction).

* * * * *

(26 U. S. C. 1946 ed., Sec. 711.)

SEC. 712 [as added by Sec. 201 of the Second Revenue Act of 1940, *supra,* and amended by Sec. 13 of the Excess Profits Tax Amendment of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess

profits credit in case of certain reorganizations of corporations, see section 741.)

* * * * *

(26 U. S. C. 1946 ed., Sec. 712.)

Revenue Act of 1945, c. 453, 59 Stat. 556:

SEC. 122. REPEAL OF EXCESS PROFITS TAX IN 1946.

(a) *In General.*—The provisions of subchapter E of chapter 2 shall not apply to any taxable year beginning after December 31, 1945.

(b) *Carry-backs from Years After 1945, Etc.*—Despite the provisions of subsection (a) of this section the provisions of subchapter E of chapter 2 shall remain in force for the purposes of the determination of the taxes imposed by such subchapter for taxable years beginning before January 1, 1946, such determination to be made as if subsection (a) had not been enacted but with the application of the amendments made by subsection (c) of this section and section 131 of this Act.

(c) *Unused Excess Profits Credit for Taxable Year Beginning After December 31, 1945.*—Section 710(c)(2) (defining the unused excess profits credit) is amended by inserting at the end thereof a new sentence reading as follows: "There shall be no unused excess profits credit for a taxable year beginning after December 31, 1946. The unused excess profits credit for a taxable year beginning in 1946 and ending in 1947 shall be an amount

which is such part of the unused excess profits credit determined under the preceding provisions of this paragraph as the number of days in such taxable year prior to January 1, 1947, is of the total number of days in such taxable year."

* * * * *

SEC. 131. FISCAL YEAR TAXPAYERS.

* * * * *

(b) *Excess Profits Tax.*—

(1) *In general.*—Section 710 (a) (imposing the excess profits tax) is amended by inserting at the end thereof the following:

"(7) *Taxable years beginning in 1945 and ending in 1946.*—In the case of a taxable year beginning in 1945 and ending in 1946, the tax shall be an amount equal to that portion of a tentative tax, computed as if the law applicable to taxable years beginning on January 1, 1945, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1946, bears to the total number of days in such taxable year."

* * * * *

(26 U. S. C. 1946 ed., Sec. 710.)

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